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## Japan's GNP Registers Modest Spring Increase

For those concerned about the health of the Japanese economy the Economic Planning Agency's figures for gross national product in the April-June 1990 quarter bore good news and bad. The good news was that the economy continued to grow at a healthy 3.6 percent annual clip in price-adjusted terms (see Table). While lower than the January-March period's real annualized 11.4 percent rate, the latest quarterly figures suggest that Japan's economic expansion continues on track. In one important respect the economy continued a trend welcomed on both sides of the Pacific: domestic demand was up sharply, while net export demand declined. Domestic demand added 2.4 percentage points to the 0.9 percent quarter-to-quarter gain, while the foreign sector shaved a relatively large 1.5 points off the overall growth rate. The decline in real exports undoubtedly was partly a reaction to developments in the January-March quarter when net exports contributed an unusual 1.3 points to GNP growth.

The bad news came in the composition of domestic growth. As in other recent quarters, plant and equipment spending led the way in the April-June period. Private fixed nonresidential investment added nearly as much to the growth rate as consumer spending even though it is only half as large. Together, these two sectors accounted for most of the growth in domestic demand. Much of the remainder resulted from the growth of private inventories. The performance of consumer spending is determined partly by the spillover effects of changed demand elsewhere in the economy, including plant and equipment spending, while inventory growth typically is erratic. Thus, business investment easily ended up the most important component in the second-quarter GNP increase.

The problems stemming from the composition of domestic demand arise from recent events affecting the Japanese economy. The Bank of Japan raised the discount rate August 30 to 6 percent, the highest level since December 1981 (see JEI Report No. 35B, September 14, 1990). The objective was to prevent the economy from overheating. While the four discount rate hikes since May 1989 have done little to cool investment fever among Japanese companies, some observers in Japan feel the latest boost might do the trick, especially since uncertainty over the outlook for the economy has increased with the crisis in the Persian Gulf. Furthermore, should that crisis portend even higher international oil prices and general inflation, the Bank of Japan has signaled its willingness to ratchet up rates still more. With interest-sensitive investment, such as that for plant and equipment, directly accounting for a substantial chunk of overall growth and indirectly for an additional amount, BOJ obviously is involved in a high-wire act with respect to its interest rate policy. Too little restraint could lead to increased inflationary pressures; too much could send the economy into a deep freeze.

Prospects for future plant and equipment spending are somewhat mixed. Some reports suggest that, faced with higher interest rates and a weak stock market, firms are pushing back spending plans to FY 1991, which begins next April. However, a Japan Development Bank survey conducted among 2,158 companies August 20 and released September 20 revealed that the respondents plan to increase investment a whopping 17 percent in nominal terms in the current fiscal year. Compared to the bank's February survey, the latest results indicate an upward revision of 8.4 points.

Japanese analysts generally remain confident that BOJ will pull off its risky interest-rate maneuver. Few believe that the increases in world oil prices and Japanese interest rates will have any immediate effect on the economy; in fact, the Japan Economic Research Center has pegged GNP growth in the July-September period at a remarkable 2.5 percent on a real quarter-to-quarter basis. The Economic Planning Agency agrees that third-quarter results will show little impact from recent events. Even after accounting for the run-up in oil prices through the end of August and the discount rate increase, Sumitomo Bank, Ltd. predicted in early September that FY 1990 will end up with a real GNP growth rate of 4.3 percent, off a mere tenth of a point from what the bank expected prior to the onset of the Persian Gulf crisis. Other banks and research institutions have made similar projections.

A growing number of analysts believe, however, that over the longer term Japan will not escape unscathed by the combination of recent events and the maturity of its economic expansion. Josen Takahashi, senior economist at Mitsubishi Research Institute and traditionally known for his pessimistic outlook,

## Japan's Real Gross National Product at Constant (1980) Prices

(in billions of yen, seasonally adjusted, quarterly totals and rates of growth at annual rates)

| | FY 1988 | FY 1989 | July-September 1989 | October-December 1989 | January-March 1990 | April-June 1990 |
|---|---|---|---|---|---|---|
| Gross National Product | Y334,968.8 (5.3%) | Y352,085.9 (5.1%) | Y350,436.1 (12.1%) | Y353,352.3 (3.4%) | Y363,040.6 (11.4%) | Y366,220.7 (3.6%) |
| Personal Consumption Spending | 185,317.8 (5.0%) | 191,184.3 (3.2%) | 190,316.4 (8.2%) | 193,336.8 (6.5%) | 194,194.5 (1.8%) | 196,970.3 (5.8%) |
| Private Residential Construction | 20,686.8 (5.3%) | 21,502.2 (3.9%) | 21,328.5 (9.4%) | 21,744.6 (8.0%) | 22,188.8 (8.4%) | 22,578.3 (7.2%) |
| Private Fixed Nonresidential Investment | 72,617.1 (17.3%) | 84,760.2 (16.7%) | 83,374.1 (28.4%) | 86,710.4 (17.0%) | 89,758.9 (14.8%) | 93,182.0 (16.1%) |
| Change in Business Inventories | 2,080.6 (*) | 1,821.5 (*) | 2,077.4 (*) | 2,117.2 (*) | 686.4 (*) | 2,068.4 (*) |
| Government Current Expenditures | 29,341.5 (2.2%) | 29,908.5 (1.9%) | 29,732.0 (1.0%) | 30,013.5 (3.8%) | 30,233.6 (3.0%) | 30,218.8 (-0.2%) |
| Government Fixed Investment | 24,621.6 (1.2%) | 24,543.3 (-0.3%) | 24,205.1 (-5.4%) | 24,509.2 (5.1%) | 24,842.4 (5.5%) | 25,370.1 (8.8%) |
| Change in Government Inventories | -185.0 (*) | -35.9 (*) | 63.4 (*) | -949.1 (*) | 357.9 (*) | 526.9 (*) |
| Net External Sector | 488.4 (-33.7%) | -1,598.2 (-427.2%) | -660.8 (235.3%) | -4,130.3 (*) | 778.1 (*) | -4,694.1 (*) |
| Exports of Goods and Services and Factor Income Received | 61,457.7 (10.7%) | 71,120.7 (15.7%) | 70,171.1 (29.1%) | 71,054.2 (5.1%) | 77,542.1 (41.8%) | 74,531.1 (-14.7%) |
| Imports of Goods and Services and Factor Income Paid | 60,969.3 (21.4%) | 72,718.9 (19.3%) | 70,831.9 (17.3%) | 75,184.5 (26.9%) | 76,764.0 (8.7%) | 79,225.2 (13.5%) |

*Cannot be calculated or meaningless.

Source: Economic Planning Agency

believes that the Japanese economy could sharply decelerate and enter a recession as early as the upcoming October-December quarter. (A recession in Japanese terms implies a sharp slowdown in growth, not negative GNP growth as it does to most analysts of the U.S. economy.) Many others believe that the crunch could come sometime next year. If it occurs before next summer, Japan's current economic expansion would fall just short of achieving the record as the longest expansion in postwar Japanese history. However, optimists have by no means disappeared. Hisao Kanamori, chairman of the influential Japan Economic Research Center, believes growth will approximate an inflation-adjusted 4 percent even in FY 1991. While a handful of analysts are even more optimistic, most expect real GNP growth to average slightly less than 4 percent, still a remarkable performance for an economy that could experience its fifth full year of expansion in FY 1991.

Douglas Ostrom

G-7 Discusses Economic Response To Persian Gulf Crisis

September 22 marked an important anniversary in efforts at international economic coordination. Yet when the finance ministers and central bank chiefs of the seven leading industrialized countries met on that day in Washington to discuss economic policy, they appeared to ignore the coincidence. Exactly five years earlier representatives of five of the seven members of the group had held their now-famous meeting in New York City to hammer out what became known as the Plaza Accord -- an agreement that significantly realigned international exchange rates. (The United States, Japan, Great Britain, France and West Germany participated in the 1985 meeting; Canada and Italy were excluded.)

The lack of commemoration this year may have symbolized growing doubts about the efficacy of the process, even though the immediate objective of the 1985 accord was easily achieved and then some. The dollar dropped against the yen and the currencies of most other industrial nations for the balance of 1985 and for most of the next three years. Against the yen it dipped to as little as half its September 1985 high of Y244.1=$1.00; in the last two years the dollar-yen exchange rate has fluctuated, with the dollar generally headed upward.

The dollar-yen exchange rate has continued to receive emphasis, however. For example, at their May 1990 meeting the Group of Seven participants expressed the view that "the present level may have undesirable consequences for the global adjustment process." That view presumably implied that the yen's then current value of approximately Y158=$1.00 was too low. If so, its Y136.65 value prior to the September 22 meeting presumably was more appropriate. Apparently supporting this view, the latest G-7 communique noted that "exchange rates were now broadly in line with continued adjustment of external balances," adding that the participants "agreed to cooperate closely on exchange markets in the context of the economic coordination process."

Despite the soothing words of the communique, some Japanese and European participants reportedly were less than happy. Not that they have any problems with the current dollar-yen exchange rate; complaining that the yen is too strong hardly would be consistent with worries over its weakness just four months earlier. Instead, the disagreements centered on the appropriate policy